<u>Editor's note</u>: 77 I.D. 181

JOSEPH I. O'NEILL, JR.
MOBIL OIL CORPORATION

IBLA 70-39 Decided October 9, 1970

Oil and Gas Leases: Extensions

> The statutory and regulatory requirements that there must be a discovery of oil or gas in paying quantities on a segregated portion of a lease in order to qualify another segregated portion of the same lease for a two-year extension cannot be construed so as to require that in every instance there must be a fully completed well on the site which is physically capable of producing oil or gas in paying quantities prior to the date of expiration.

IBLA 70-39 : NM 027994-A

: NM 027994-C

JOSEPH I. O'NEILL, JR. : Oil and Gas Lease
and : extension
MOBIL OIL CORPORATION

: Reversed and Remanded

APPEAL FROM THE BUREAU OF LAND MANAGEMENT

Joseph I. O'Neill, Jr. and Mobil Oil Corporation have each appealed from the February 28, 1969, decision of the Chief, Branch of Mineral Appeals, which affirmed the decision of the Santa Fe land office in declaring that appellants' oil and gas leases had expired and in rejecting their respective applications for two-year extensions pursuant to 30 U.S.C. 187a (1964).

The facts are that the original noncompetitive lease, NM 027994, was issued November 1, 1956, and included all of the lands hereinafter discussed. The lease was segregated by various partial assignments creating leases NM 027994-A through NM 027994-F. The retained portion of the base lease (NM 027994) expired on October 31, 1966, as did NM 027994-B. Lease NM 027994-D was extended under 43 CFR 3128.5(b) 1/ to June 30, 1968, and further extended to June 30, 1970, pursuant to 43 CFR 3127.2 2/ (diligent drilling operations being conducted on June 30, 1968). The remaining segregated leases were extended under 43 CFR 3128.5(b) to September 30, 1968.

Prior to the expiration date, Mr. O'Neill and Mobil Oil Corporation, lessees under NM 027994-A and NM 027994-C, respectively, requested that their leases be extended for two years on the basis of a discovery of oil and gas in paying quantities on another segregated portion of the original leasehold, i.e., on NM 027994-D, as provided by 43 CFR 3128.5 3/. Advance rentals for the following

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1/ Since renumbered 43 CFR 3107.6-3.

2/ Since renumbered 43 CFR 3107.2-3.

3/ The request of Mobil Oil Corporation is not contained in the case record. However, the recitation of its receipt in the land office decision of November 1, 1968, plus the land office receipt for payment of advance rental for the following year, are adequate evidence that such a request was in fact received.

lease year were tendered by O'Neill and Mobil prior to the regular expiration date of their respective leases, and receipts therefor were issued by the land office.

O'Neill's application for extension stated the following:

> United States lease NM 027994-D covering, among other lands, W/2 NE/4 Section 12, said township and range, is the subject of drilling operations by Pennzoil United, Inc., such well being called the Mobil Federal #12-1, Eddy County, New Mexico. This is a part of original parent lease NM-027994. Drillstem tests have been taken in said well in the Wolfcamp Formation, Strawn Formation and Atoka Formation, which definitely indicate a discovery of oil and gas in commercial quantities on August 12, August 13, August 19 and September 17, 1968.
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> Copy of affidavit of the drilling superintendent of Pennzoil United, Inc. is attached hereto and the logs referred to in said affidavit are furnished herewith to United States Geological Survey Office, Roswell, New Mexico, together with a copy of this letter and affidavit. It is requested that such logs remain confidential information available only to government personnel to the extent necessary to verify the discovery referred to above.

In reporting to the land office with reference to the alleged discovery, the Regional Oil and Gas Supervisor, Geological Survey, said:

> This office does not disagree with the drillstem test data submitted by Mr. O'Neill . . . . We do not, however, agree with his claim that a discovery has been made in the well on the "D" lease prior to September 30, 1968, which would entitle [the other leases] to a two-year extension pursuant to 43 CFR 3128.5(a).
>
> The pertinent regulation requires that in order for a segregated portion of a lease to qualify for a two-year extension as a result of a discovery on another segregated portion, such discovery must be a "discovery of oil or gas in paying quantities."

> Accordingly, there must be a well on one of the segregated portions of the lease that is capable of producing oil or gas in paying quantities on or before the expiration date of the other segregated portions. The Chief, Branch of Mineral Appeals, Division of Appeals, held in his decision of April 17, 1962, in the case of Texas-National Petroleum Company, lease New Mexico 021121, that a discovery means a well that is physically capable of producing oil or gas in paying quantities. Solicitor's Opinion A-20153 (Carl Losey et al., dated December 4, 1964, involving leases Salt Lake City 071373 and 071374) states the following in the penultimate paragraph on page 3: "The Department has held that the phrase 'well capable of producing' means 'a well which is actually in a condition to produce at a particular time in question." * * * An assertion that a well is commercially productive will not extend the lease when a lessee fails to submit satisfactory evidence that he has a well capable of present production in paying quantities."
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> As drilling operations are continuing at the well on the "D" lease, it is clear that the well is not a discovery which would serve to extend the other segregated leases because such a well was not physically completed so as to be capable of producing oil and gas in paying quantities on September 30, 1968.

The report continued with an expression of the Supervisor's opinion that although the drillstem test results indicated that the intervals tested "are possibly productive in paying quantities . . . sustained production might prove the well not to be capable of producing oil or gas in paying quantities," and concluded with the following:

> In any case, the well was not physically capable of producing oil or gas in paying quantities on September 30, 1968. Accordingly, it is our opinion that leases New Mexico 027994-A, 027994-C, 027994-E, and 027994-F are not qualified for a two-year extension pursuant to 43 CFR 3128.5(a) and it is recommended that such leases be considered to have expired by their own terms as of September 30, 1968.

The land office decision of November 1, 1968, held that the leases in question had expired because in order to qualify for a two-year extension there must be a well on one of the segregated portions of the original lease that is capable of producing oil or gas in paying quantities on or before the expiration date of the other segregated portions.

On appeal to the Director, Bureau of Land Management, the land office decision was affirmed by the Chief, Branch of Mineral Appeals, who held that the statutory requirement for discovery of oil or gas in paying quantities is not met until there is on the lease a well capable of producing oil or gas in paying quantities after drilling has been completed, casing set and cemented, and perforations made into the appropriate horizon so that the well is physically capable of production, citing United Manufacturing Co., et al., 65 I.D. 106 (1958) and Joseph C. Sterge, 70 I.D. 375 (1963).

On appeal to the Department from that decision appellants argue that neither the statute nor the regulation requires that there be a completed well fully capable of economic production on the segregated portion of the lease prior to the expiration date in order to effect a discovery. They aver that courts have held that the primary meaning of the word "discovery" does not include production, it merely means to find, citing Continental Oil Company v. Boston Texas Land Trust, 221 F. 2d 124 (5th Cir. 1955).

They further contend that the drillstem tests made in the four formations between August 12 and September 17, 1968, truly indicated a discovery of paying quantities of gas as evidenced by the daily drilling reports, the dual induction-laterolog, sidewall neutron porosity log, microlog, and borehole compensated sonic log-gamma ray (all of which were furnished to the Geological Survey). In support of this contention they offer the affidavits of the drilling superintendent, the manager of production for Pennzoil United, Inc., (a qualified production engineer), and an independent petroleum engineer, each of whom expressed his opinion that the drillstem tests constituted a discovery. Moreover, appellants have submitted a copy of the well completion report showing that the well was completed as a gas producer from the Atoka formation on November 25, 1968. With reference to the statement by the Regional Oil and Gas Supervisor that sustained production might prove the well incapable of producing in paying quantities, they contend that the same criticism could be leveled at the initial potential test (after well completion), which is accepted by the Geological Survey, saying that any well can become incapable of producing in paying quantities at any later date.

In summary, appellants say that the Bureau of Land Management and the Geological Survey have added to the statute a requirement which frustrates the law and the regulation and goes beyond the intention of the Congress by substituting the need for a completed well instead of discovery.

The term "discovery of oil or gas in paying quantities" did not originate with this legislation. On the contrary, it has long been employed in private leases and has been considered and defined in numerous judicial proceedings. See text and cases collected in 2 Summers, THE LAW OF OIL AND GAS § 300. In Texas Pacific Coal and Oil Co. v. Bratton, 239 S.W. 688 (Tex. Civ. App. 1921) the court said:

> The predicate for a continuation of the lease . . . having been stated to be simply the discovery of oil during the five years' period, another predicate, namely "the production of oil in paying quantities" within the five years' period cannot be implied and read into the lease as a substitute for, or qualification of, the predicate stated, which is clear and unambiguous.

The primary meaning of the word "discover" being to find, and in this instance to find something not known before, this necessarily is the meaning of the term when used in connection with exploratory operations, since such operations are designed solely for the purpose of determining whether or not the land contains oil or gas in sufficient quantities for profitable production. The private lease usually provides that, if during the exploratory period oil or gas is found or discovered in paying quantities, thereafter the lease shall continue in full force and effect. Bouldin v. Gulf Production Co. 5 S.W. 2d 1019, 1023 (Tex. Civ. App. 1928); cited with approval in Continental Oil Co. v. Boston Texas Land Trust, supra.

The act of July 29, 1954, 68 Stat. 585; 30 U.S.C. 188(b), added the following, inter alia, to section 31 of the Mineral Leasing Act, as amended:

> . . . upon failure of a lessee to pay rental on or before the anniversary date of the lease, for any lease on which there is no well capable of producing oil or gas in paying quantities, the lease shall automatically terminate . . . . (Emphasis added.)

As indicated, the foregoing imposes a specific statutory requirement for a well capable of producing oil or gas in paying quantities if the lease is to be spared automatic termination in consequence of non-payment of rental. By contrast, however, the act of August 8, 1946, 60 Stat. 955; 30 U.S.C. 187a provides, in pertinent part, that

> Any partial assignment of any lease shall segregate the assigned and retained portions thereof . . . and such segregated leases shall continue in full force and effect for the primary term of the original lease, but for not less than two years <u>after the date of discovery of oil or gas in paying quantities</u> upon any other segregated portion of the lands originally subject to such lease. (Emphasis added)

The last-quoted statute, of course, is the one with which this appeal is concerned, since it affords the benefit sought by the appellants. However, all of the authorities relied upon by the Bureau of Land Management and the Geological Survey to establish that a completed well is required involve cases arising out of non-payment of rentals and the consequent termination of the leases pursuant to 30 U.S.C. 188(b). The conclusion is inescapable that BLM and the Survey have taken the requirement for a well capable of producing oil or gas in paying quantities, which was written into 30 U.S.C. 188(b) as a saving clause, and superimposed it on 30 U.S.C. 187a, as the essential test of a discovery of oil or gas in paying quantities.

We think such interpretation is improper. There is no basis for believing that in 1946, when the Congress provided that discovery of oil or gas in paying quantities would qualify another segregated portion of the same lease for extension, it intended to impose a requirement not even articulated in the Mineral Leasing Act until eight years later in an amendment dealing with non-payment of lease rental -- an entirely different situation. Had it been the intent of Congress that there must be a completed well physically capable of economic production in order to qualify the extension it could easily have so provided. It did not. Only "discovery of oil and gas in paying quantities" is required.

This is not to say that in no event will it ever be necessary to complete a well in order to demonstrate a qualifying discovery. We recognize that situations may arise where adequate testing has not been accomplished or test results and other evidence are inconclusive and only the initial production test after completion of the well will demonstrate whether a discovery has been made. However, where all the evidence and expert opinion is reasonably persuasive of the fact of a discovery of paying quantities of oil or gas, as in this instance, it is error to hold that such evidence must be disregarded because the law and/or the regulations require a completed well, physically capable of oil or gas production in paying quantities.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior (211 DM 13.5; 35 F.R. 12081), the Bureau decision of February 28, 1969, is reversed, and the case records are remanded to the land office with instructions to grant the lessees two year extensions effective as of the date hereof.

Edward W. Stuebing, Member

I concur:

Newton Frishberg, Chairman

I concur:

Francis E. Mayhue, Member